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SUBJECT: KAZAKHSTAN: ITALY REMAINS A MAJOR INVESTOR, ACTIVE IN
SEVERAL KEY SECTORS OF THE ECONOMY

¶1. (U) Sensitive but unclassified. Not for public Internet.

¶2. (SBU) SUMMARY: PolOff met on February 17 with Ugo Boni, First Secretary and DCM at the Italian Embassy in Astana, to discuss the Kazakhstan-Italy relationship. Boni characterized the overall Kazakhstan-Italy relationship as positive and robust, and said that both sides looked forward to President Nazarbayev's planned visit to Italy sometime during 2009. Boni told PolOff that the Italian government's top priority in Kazakhstan is pursuing energy security, followed by strengthening other commercial ties. Italy remains one of the major sources of foreign direct investment in Kazakhstan, and several Italian companies remain active in the construction, property management, construction materials, fashion, and alcohol sectors, despite the effects of the global financial crisis. Italian companies in the construction sector complain of pressure and delayed payments from local and central authorities, while fashion and wine exporters complain that profits are primarily being captured by customs and local retailers. Boni told PolOff that he did not expect finalization in the near future of an EU-Kazakhstan agreement on Kazakhstan's WTO accession. END SUMMARY.

NAZARBAYEV PLANS TO VISIT ITALY

¶3. (SBU) Boni characterized the overall Kazakhstan-Italy relationship as very positive and robust. Italy's Prime Minister, Silvio Berlusconi, visited Kazakhstan briefly in 2008. (NOTE: He was supposed to make a technical refueling stop, but President Nazarbayev invited him into town, and they had a lengthy meeting and windshield tour of Astana. END NOTE.) Boni said that Nazarbayev had planned to visit Italy in March, but also wanted to call on the Pope. Since the Pope expects to be abroad in March, the Nazarbayev trip was postponed to "later in 2009." Boni expressed some relief at the postponement, noting that the Kazakhstani side hopes to sign a range of commercial agreements which will take time to prepare.

TOP PRIORITY IS ENERGY SECURITY

¶4. (SBU) Boni said the Italian government's top priority in Kazakhstan is pursuing its energy security, since Italy is a major importer of Kazakhstani crude oil. However, Boni explained that the Italian Embassy's role is primarily one of quiet support, since

policy is made at the EU-level. Boni also maintained that oil-related issues are not really a "bilateral" EU issue with Kazakhstan, but also involve the EU-Russia relationship. "Without Russia, it is impossible to generate agreement," Boni claimed.

15. (SBU) Boni reminded PolOff that the most important Italian company with a presence in Kazakhstan is Italy's national oil company Eni. However, he said that much of Eni's investment is channeled through the Netherlands, which results in a statistical understatement of Italy's importance as a foreign investor in Kazakhstan. Boni maintained that that Eni, along with many other Western oil companies, finds it very difficult to meet local content requirements. Boni asked, "Where can you find certain goods made in Kazakhstan? Local content requirements are a huge problem for our companies in the oil sector." At the same time, Boni said that many Italian companies complain that Eni does not favor Italian companies enough, but Boni explained that for items Eni cannot procure from local suppliers, Eni typically uses the same diverse international network of suppliers it relies on for projects in other countries.

ITALY REMAINS A MAJOR SOURCE OF INVESTMENT

16. (SBU) Boni said that Kazakhstan and Italy have had a robust economic relationship since Kazakhstan became independent. In 2008, total trade between Kazakhstan and Italy amounted to over \$13 billion, including over \$11 billion worth of Kazakhstan exports to Italy (primarily oil) and more than \$1 billion in Kazakhstani imports. Italy officially ranks fourth in terms of cumulative foreign direct investment (FDI) in Kazakhstan, behind the United States, the Netherlands, and the United Kingdom. Boni expects Italy to continue to be a significant foreign investor in Kazakhstan,

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although he noted that Italian investment outside of the oil sector has been declining since 2006. Boni attributes the decline to a fall in Kazakhstani demand and an increase in competition. For example, during the 1990s, many Italian companies moved quickly into the newly open Kazakhstani construction market and used their expertise to build high quality buildings cheaply and quickly. As more local and foreign companies entered the market, it became saturated, and Italian construction companies withdrew or moved into the property management business.

PROBLEMS WITH CEMENT FACTORY INVESTMENT

17. (SBU) Italy's second largest commercial investor in Kazakhstan is Italcementi, the world's fifth largest cement-producer, which acquired the Shymkent cement factory in 1998. According to Boni, the Shymkent factory's operations have been problematic because of pressure from local authorities. Cement prices in Kazakhstan are controlled by the government, but actual free-market prices are much higher, which creates a lucrative trade for intermediaries. Boni told PolOff that the factory's production is frequently stopped by local authorities, who claim that the company does not have the "necessary permits." This is a pretext for demanding bribes or other compensation. Such problems were particularly egregious during the spike in world cement demand in 2007. Kazakhstan was particularly affected by China's demand for cement and other construction materials in the run-up to the Summer 2008 Olympics, which also coincided with building booms in Astana and Almaty, Boni argued.

MINISTRY OF TRANSPORTATION DELAYS PAYMENT

18. (SBU) Other Italian companies have also faced problems with Kazakhstani authorities. The large Italian company Grupo Todini, controlled by prominent Italian politician Luisa Todini, has been active in construction and road-building in Kazakhstan for 12 years, and completed two roads in western Kazakhstan, one from Atyrau to Aktau and one from Atyrau to Samara, Russia. Boni told PolOff that the Kazakhstani Ministry of Transport paid the company approximately \$8 million less than the amount due. Although the company has the right to take the case to international arbitration and is confident it would win, Boni said Grupo Todini is reluctant to take this step for fear that it could endanger future deals. The company is

currently completing one-fifth of the road from Astana to the resort of Borovoye; the other four sections are being completed by one Iranian and three Kazakhstani companies. According to Boni, all of the companies, including Todini, were forced to purchase materials at prices at least seven times the officially set rates, without being able to recover payment from the Ministry of Transportation.

PROPERTY MANAGEMENT MORE LUCRATIVE

¶9. (SBU) Despite the hardships several larger Italian companies face doing business in Kazakhstan, several medium-sized firms have successfully carved out niches, especially in property management. Boni told PolOff that Renco is well-established in property management in Kazakhstan. The company's largest market is Armenia, where it dominates the construction sector, whereas in Kazakhstan it is a medium-sized, but highly successful company. According to Boni, Renco, which was started by an Eni employee, moved successively from oil services to construction and then to property management, and now manages a large number of the buildings it constructed, including the office building in Almaty where USAID is located, the Astana Renco building which houses a number of diplomatic missions, and several hotels located adjacent to oil fields. Boni said that the company wisely moved out of the Kazakhstani construction market after the 1990s just as lower-cost firms entered it. Renco then used its brand and its knowledge of basic Western service standards to become successful in property management.

GLOBAL FINANCIAL CRISIS TAKES ITS TOLL ON BANKING INVESTMENT

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¶10. (SBU) Boni admitted that the global financial crisis is having a negative effect on Kazakhstan-Italy commercial relations. Italy-based Unicredit bought Kazakhstan's ATF bank in 2007, but this acquisition has lost 90 percent of its value. Boni also expressed concern over the Kazakhstani government's reorganization and nationalization of banks as an anti-financial crisis measure. Boni said that the Director of the Italian Trade Delegation in Almaty believes "the nationalization of Alliance Bank is a big scam." Boni said that the government take-over of BTA Bank was "not a positive step." BTA, Boni claimed, was well-known even outside of Kazakhstan as a sound financial institution. Boni admitted that he had even put some of his own money in BTA, judging it to be the safest of the Kazakhstani banks, and that he had been one of the many people who had rushed to the bank to withdraw money after the nationalization. (NOTE: International financial institution and Western private-sector bankers have told us the opposite --that BTA was badly over-extended and frequently cooked its books. END NOTE.)

ITALIAN COMPANIES CONTINUE COMMERCE IN FASHION AND WINE

¶11. (SBU) Despite the financial crisis, Boni expects small and medium-sized Italian firms to continue to develop their markets in Kazakhstan, particularly in the fashion and wine industries in which Italian firms have been highly successful. Boni told PolOff that Italian exporters have used their reputation for high quality fashion to capture large parts of the high-end clothing market, especially for lucrative fur goods. At a November exposition in Almaty, one businessman sold his entire stock, worth \$50,000, on the first day. (NOTE: Prominent Kazakhstani businessman Nurlan Kapparov, who heads the Lancaster Group holding company, is the chairman of the Kazakhstan-Italy Business Council. His wife reportedly owns many boutiques featuring Italian brand-name products such as MaxMara and Dolce and Gabbana. END NOTE.)

¶12. (SBU) Many small Italian companies continue to be active exporters of wine to Kazakhstan. According to Boni, however, Italian wine exporters have failed to build a strong lobby, and therefore, lack collective bargaining power. Most Italian wine exporters, except for larger companies like Martini, are unable to effectively capture the profits from their products. For a bottle of wine that costs \$10 in Italy, Kazakhstani retailers can get \$20 or more, but most of the mark-up goes into the pockets of local retailers or is taken by customs in the form of import duties.

ROME WAS NOT BUILT IN A DAY

¶13. (SBU) Boni explained that for Italy, Kazakhstan's accession to the WTO is an EU-level issue -- and one that involves Russia. According to Boni, the EU would like to have an accession agreement with Russia before Kazakhstan joins the WTO, and therefore Boni does not expect quick finalization on an EU-Kazakhstan accession agreement. Regarding the proposed customs union among Kazakhstan, Russia, and Belarus, Boni expressed doubts it would soon come to fruition -- despite claims from the three participating countries that it will. As Boni put it, "Developing a customs union is very complicated. It took 12 years for the EU to come together."

HOAGLAND